Cost data provided to the FCC in filings by inmate telephone calling service providers also provide confirmation of the conclusions reached below.

51. The following calculations are intended to quantify a range of rates that would need to be charged by the underlying system provider under the proposal. These rates are intended to be profitable for the underlying system provider; thus, the rates include a profit margin in addition to costs. Because Evercom is the primary provider in the prisons under examination, the first set of calculations is based upon Evercom's costs as an example of how such costs might be calculated. The costs for other experienced providers should be similar.

52. Based on my knowledge of the industry, financial reports from Evercom,[14] and evidence about Evercom's and other inmate service providers' costs from the public record in other cases, the basic components of prison system costs are defined below. The costs of a prison calling system include the hardware that makes up the prison phone system, maintenance, billing, administration and sales, uncollectibles, and the cost of providing long distance transmission and local termination.

53. The hardware in a prison calling system consists of the switch, the recording system, the monitoring interface and the cost of telephones in those cases where the phones are not provided by the prison. The cost of switching hardware has dropped tremendously over the past few years. There are two primary types of switches that can be purchased -- carrier class switches and enterprise switches.[15] A carrier class switch must be able to interface with the

[14] Evercom's December 31, 2000 Independent Auditor's Report by Deloitte & Touche LLP is an attachment to the 10-K Report, relevant portions of which are attached as Exhibit 2 hereto. I have also reviewed Evercom's 10-Q Report for the quarter ended September 30, 2001. Evercom's 10-K Report for 2000 is the most recent SEC report covering a full year, however. Because the September 30, 2001 10-Q Report covers only one quarter and shows little change from the data in the 10-K Report relevant to this analysis, this affidavit relies on the more complete 10-K Report.

[15] As used in this discussion, the term "enterprise switch" has a different meaning from the way that term is used in the FCC's *Triennial Review Order*. *See Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Report and Order and Order on

larger public switched telephone network and is generally used only by LECs. The switches required for prisons are enterprise switches, and are somewhat analogous to the large PBXs used by many businesses. Because enterprise switches are smaller and simpler than carrier class switches, they are far less expensive. A switch has several major components -- the line side connections, the trunk side connections, the operating software and a user interface. The line side connection is the hardware that interfaces with the telephone sets that use the switch. From the line side perspective, prison switches are relatively small switches. According to data included in the June 2, 1997 BOP RFP, the average federal prison has just under 44 telephone sets.[16] The trunk side connection is the interface to the public telephone network. As described elsewhere in this paper, these switches today only require only a handful of T-1 connections to the public switched telephone network -- making these relatively small switches. The most costly feature on a prison switch is the specific software that allows the switch to meet the various penological requirements listed earlier. If one were to develop such a switch for only one prison, such software would be quite expensive. However, most prison providers supply switching to many prisons, thus lowering the cost of this software on a per location basis. Evercom supplies switches to about 2,000 prisons, and thus its software cost is spread over many locations and is relatively inexpensive per switch.

54. The cost of switching has dropped drastically over the last few years. As an example, a small Class 5 carrier grade switch that can handle 5,000 lines would have cost $2 million - $3 million just a few years ago. In the last several months, such switches have been available from every major switch manufacturer -- Lucent, Nortel and Siemens, plus a number of the new soft switch manufacturers -- for under $600,000, due in part to the collapsing of the

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Remand and Further Notice of Proposed Rulemaking, CC Docket No. 01-338, FCC 03-36 (Aug. 21, 2003). There, "enterprise switch," *see id.* at ¶ 428 n.1335, refers not to a type of switch but to any carrier class switch used by a CLEC to serve large business customers. *Id.* at ¶¶ 419-22. Here, it refers to the type of switch used by large non-carrier entities.

[16] *See* BOP RFP, Exhibit J-1, attached hereto as Exhibit 5 (3850 telephones in 88 prisons).

telecom sector and resulting overcapacity. Even as far back as 1999, this Commission calculated that carrier class switches cost less than $500,000.[17] Switch costs have fallen considerably since then, and especially since the collapse of the high-tech bubble. Recently, observers have found carrier switches advertised for as little as $100,000.[18] As noted above, enterprise switches are far simpler and less expensive than carrier switches. Based on my recent experience in pricing switches for clients, a conservative current estimate for an enterprise switch with the features needed for a prison telephone system, including monitoring and recording equipment, would be approximately $350,000.

55. Moreover, there is a trend in the switching world that is going to lower the cost of switching even further in the near future, and this innovation is particularly relevant to prison calling systems. There are a number of new switches in the market referred to as soft switches. A soft switch is a switching device that separates the various switching functions into separate components. The major components of a soft switch are referred to as the call processor, the media gateway, the signaling gateway and the feature server. The call processor is the same as the core of the older switches and is the device that actually switches and routes calls. The media gateway is a device that allows for the interface to various other switching platforms. There is no real analog to the media gateway in older switches -- they were proprietary and self-contained. The signaling gateway allows the switch to interface with the SS7 network and thus use advanced features such as caller ID. Finally, the call feature server is the device that contains the unique systems and programs that operate the various features on the switch. The feature server in a soft switch would contain all of the unique penological features that distinguish prison

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[17] *See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696, 3812-13 (1999).

[18] "State Regulators Courted by ILECs and IXCs on UNE-P Role," Communications Daily, April 28, 2003, at 2 (comment attributed to Link Hoewing, Verizon Assistant Vice President-Internet), attached hereto as Exhibit 6.

switching systems from other systems. The availability of soft switches is relevant because they will allow a further large reduction in the cost of providing prison calling. With a soft switch platform, a prison provider could serve many prisons from one switching platform. For example, it would need only one feature server and one signaling gateway at some central site in the U.S. At each prison, it would need only the call processor. Such a distributed network would probably represent an additional 50 percent reduction over today's cost of switching, and this distributed architecture is ideally suited for applications like prison calling that require services at many different locations. Thus, any costs quoted in this paper can be expected to further decrease over time as technology takes yet another leap forward.

56. Service providers like Evercom are often required to provide the telephone sets as part of providing service to a prison. The phones used by prisons are more expensive than the average phones used by most business and residential users. Prison phones are more like payphone sets, in that they are built to stand up to heavy use. There are a vast number of types of payphones available in the marketplace. Payphones vary in the functions they must perform and in the ruggedness of the environment for which they are constructed. Prison payphones can be of the "dumb" variety, *i.e.*, they do not need to be able to perform such functions as coin counting. "Smart" telephones that process coins cost more than dumb phones that do not. Additionally, a prison phone does not need any of the advanced features often seen on payphones today, such as a scanner that can read in calling card information from a caller. Prison payphones can be of the most basic type, in that they require a keypad on which to dial the desired numbers, and, in the case of the competition proposal presented in this affidavit, to choose the desired IXC, but very little else. The payphone industry is very competitive, and there are a large number of manufacturers and thus a wide range of prices. Based on recent market research, there are

payphones that would work in a prison environment that are available from as low as $280 up to $550, with an average prison payphone price of $400.[19]

57. In order to translate that per-phone set estimate into an estimated payphone equipment cost for a typical prison, it is necessary to examine prison inmate telephone data. The data in the BOP RFP shows that the federal prison system has one telephone for every 25 prisoners.[20] Using a subset of the federal data, an attachment to a report from the Virginia State Corporation Commission[21] shows a ratio of 1 telephone per 26 inmates.[22] The three sample CCA prisons served by Evercom have an average capacity of 1,743 prisoners[23] Using that sample, applying a ratio of one phone per 25 inmates yields an average of 70 telephones per prison. Applying the $400 average payphone cost to the estimate of 70 phones per sample prison yields a total payphone cost of $28,000 per prison. Adding that cost to the $350,000 switch estimate above results in an average total equipment cost per prison of $378,000.

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[19] Attached as Exhibit 7 are sample advertisements from payphone websites for equipment that would be suitable for inmate services showing prices as low as $149. An estimate of $400 for an inmate telephone set is also consistent with the Commission's estimate of $225 for a coinless payphone for general use in the Third Report and Order, and Order on Reconsideration of the Second Report and Order, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd 2545, 2622, 2634 n.404 (1999), *aff'd sub nom. American Pub. Communications Council v. FCC*, 215 F.3d 51 (D.C. Cir. 2000).

[20] *See* BOP RFP, Exhibit J-1, attached hereto as Exhibit 5. The total number of federal prisoners shown in this chart is 97,579, and the total number of phones is 3,850, or 25.35 prisoners per phone.

[21] Div. of Communs., Virginia State Corp. Comm'n, Report on Rates Charged to Recipients of Inmate Long Distance Calls (2000) ("Virginia Inmate Report"), attached hereto as Exhibit 8.

[22] Analysis of the Federal Bureau of Prisons Inmate Telephone System and Applicability to the California Department of Corrections, Executive Summary at 1 ("CDC Report") (attached to Virginia Inmate Report) (see Exhibit 8).

[23] The three prisons are as follows: Central Arizona Detention Center – 2,304, Torrence County Detention Facility – 910, and Northeast Ohio Correction Center – 2,016. *See* Correctional Corporation of America web site, *at* http://www.correctionscorp.com/map.html.

58. In deriving an estimate of total operating costs, the cost of the switch and the telephones is reflected as depreciation expense. Evercom's audited financial statements show that it uses straight-line depreciation and that it uses depreciation lives of between 3.5 years and 7.5 years for telephone system equipment.[24] In the cost calculation set forth below, a depreciation life of 5.5 years is used, which is in the middle of Evercom's range of depreciation lives. This depreciation life also aligns very well with the typical length of a typical inmate service provider contract with a prison system, which is approximately five years,[25] and with data filed by the Inmate Calling Services Providers Coalition ("Coalition"),[26] of which Evercom is a member.[27]

59. Another major cost of providing service is maintenance expense. Maintenance expense includes spare parts, repairs and the personnel required to answer customer questions and keep the systems working. Most companies budget maintenance as a percentage of equipment costs. This ratio can be used for Evercom by taking the maintenance expense figure set forth in its 10-K Report. There, Evercom states that its maintenance expense has been steady

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[24] *See* 10-K Report at Part II, Item 8, Notes to Consolidated Financial Statements, Note 1, "Property and Equipment," attached hereto as Exhibit 2.

[25] *See* Carver, 54 Fed. Comm. L.J. at 395 n.20, attached as Exhibit 4 hereto.

[26] The Coalition uses a depreciation life of five years in its calculations of equipment costs. *See, e.g.,* Don J. Wood *et al.*, "Inmate Phone Local Call Cost Study" D.3.3 (May 24, 2002) ("Inmate Cost Study") (attached to Comments of the Inmate Calling Service Providers Coalition, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128 (May 24, 2002) ("2002 Coalition Comments")). The relevant portions of the 2002 Coalition Comments are attached hereto as Exhibit 9.

[27] *See ex parte* letter from Robert F. Aldrich, Counsel to the Inmate Calling Service Providers Coalition, to Magalie Roman Salas, Secretary, FCC, at attachment captioned "Independent Inmate Phone Service Providers (as of May, 2000)" (May 9, 2000), the relevant portions of which are attached as Exhibit 10 hereto.

and varies little over time.[28] The amount of maintenance expense equates to approximately 13.2 percent of equipment costs.[29] This is the ratio used for estimating maintenance expense in the operating cost calculations set forth below.

60. Another cost that prison providers face is billing costs. Most inmate calling service providers do not have direct billing relationships with the family members of prisoners, or others receiving collect calls from prisoners, across the U.S. Instead, the inmate service providers typically pay a third party, usually the Regional Bell Operating Company or other LEC serving the party paying for an inmate call, to bill such parties for them. In its 10-K Report, Evercom states that billing costs paid to third parties vary between 2 percent and 3 percent of the revenues billed.[30] Accordingly, in the cost calculations set forth below, a figure equivalent to 2.5 percent of revenues is used to estimate billing costs, It should be noted that significant billing costs apply only to collect calling. The only billing cost required for a debit call is the cost of electronically extracting revenues from the pre-paid debit account, an insignificant expense per transaction. Given that Evercom provides both collect and debit calling to inmates, its reported billing costs represent an average for both types of services. Thus, its actual billing costs for collect calling only are probably much higher than 2.5 percent of collect calling revenues.

61. In order to derive an estimate of billing costs, it is necessary to compute a composite average per-minute revenue amount to which the 2.5 percent ratio can be applied. The ratio of collect to debit calling varies from prison to prison, although there is still more collect calling than debit calling. For simplicity, it is assumed that, once this competitive

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[28] 10-K Report at Part II, Item 7, "Field Operations and Maintenance," attached hereto as Exhibit 2.

[29] Evercom's 10-K Report shows maintenance expense of $6.67 million (in Part II, Item 6) and total equipment costs of $50.39 (in Part II, Item 8, Note 4 to Consolidated Financial Statements, "Property and Equipment"), a ratio of 13.2 percent ($6.67M/ $50.39M). *See* Exhibit 2.

[30] *Id.* at Part I, Item 1, "Billing Arrangements."

proposal is adopted, it would be reasonable to expect that half of the calls will be debit calls and half will be collect. Using Evercom's tariffed rates during a portion of the period it was providing service to the CADC, TCDF and NOCC -- a debit card rate of $0.65 per minute and a collect calling rate of $0.59 per minute plus a $3.95 per collect call charge -- and assuming a ten-minute call, the composite calling rate charged to inmates would be $0.82 per minute in the cost calculation below.[31] If prisons were to switch to debit calling only for inmate calls, billing costs would essentially disappear.

62. Another major cost for inmate service providers offering collect calling is the cost of uncollectibles, as mentioned previously. Evercom does not show uncollectibles as a separate item in the financial statements in its 10-K Report. Evercom does state in the 10-K Report, however, that although inmate prepaid calling services have minimal uncollectible expenses,[32] called parties' failure to pay for inmate collect calls place unique demands on this sector of the industry.[33] Data provided by the Coalition in an *ex parte* letter filed in April 2000 with an

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[31] During the period from September 14, 1999 to the detariffing of Evercom's rates on June 27, 2000, Evercom's standard tariffed debit card service rate, which applied to its Inmate-only Debit Account Service, was $0.65 per minute. *See* Evercom Systems, Inc. Tariff FCC No. 1, Section 3.4.1 (effective Sept. 14, 1999), and FCC Public Notice, Tariff Transmittal Public Reference Log (June 29, 2000), and its standard tariffed rate for interstate, interexchange operator assisted inmate calls, including collect calls, was $0.59 per minute plus a $3.95 service charge. *See* Evercom Systems, Inc. Tariff FCC No. 1, Section 3.5 (effective Sept. 14, 1999). For a ten-minute collect call, that comes to $0.99 per minute for collect calls. The average of $0.65 and $0.99 is $0.82 per minute. The relevant portions of Evercom's Tariff No. 1 are attached as Exhibit 11 hereto.

It should be noted that in the event that this competitive proposal is adopted, actual inmate rates will be far lower than they have been in the recent past. The 82 cent rate is used here purely as a conservative estimate. As demonstrated below, the cost of billing drops out in deriving the cost of providing the underlying inmate telephone system.

[32] 10-K Report at Part I, Item 1, "Products and Services" ("Prepaid Services"), attached hereto as Exhibit 2.

[33] *Id.* at Part I, Item 1, "Industry Overview."

attached analysis of the cost of providing a 12-minute local inmate collect call ("Coalition Cost Analysis"), show a typical uncollectibles rate for inmate collect calling of 14 percent of revenues, and, in some cases, over 23 percent.[34] Accordingly, the cost calculation below uses a 15 percent uncollectibles rate to apply to collect calling. Because there are virtually no uncollectibles from debit calls, for which revenue is collected directly from prepaid accounts, however, the overall uncollectibles rate must be adjusted to take into account a mix of collect and debit calling. Using the assumption discussed above that half of the calls will be debit calls and half will be collect, the composite uncollectible rate would be 7.5 percent of total revenue, and that rate is applied to an assumed composite calling rate of 82 cents per minute in the cost calculation below.[35]

63. One of the largest costs incurred by inmate calling service providers is the category of "Administration, General and Sales" expenses. On Evercom's financial statements, this includes a broad category of costs. In addition to the cost of the salespeople who sell to prisons and related expenses, it includes the following types of costs: executive salaries, board of director expenses, accounting, legal, human resources, computer networks, insurance, the cost of running corporate headquarters and other overhead costs. In Evercom's case, for 2000, these costs were roughly 2.6 times greater than maintenance costs.[36] Accordingly, a ratio of 2.6 times

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[34] *Ex parte* letter from Jacob S. Farber, Counsel to the Inmate Calling Service Providers Coalition, to Magalie Roman Salas, Secretary, FCC, at attachment, "Inmate Service Fee - 12 Minute Local Call Cost Analysis" (April 6, 2000) (uncollectibles rate for inmate collect calls of 14 percent) ("Coalition Cost Analysis"), attached hereto as Exhibit 12. *See also,* 2002 Coalition Comments at 3-4; Inmate Cost Study at Workpapers labelled Input C, Input G, Input H, Input N, Input O and Input P (showing inmate collect uncollectibles rate of over 23 percent), and Input Q (showing uncollectibles rate of over 19 percent), attached hereto as Exhibit 9.

[35] As explained below, the cost of uncollectibles, like billing costs, drops out in deriving the cost of providing the underlying inmate telephone system, since the underlying system operator recovers its costs through rates charged to the competitive interconnected long distance carriers terminating each call, obviating any billing or uncollectibles costs.

[36] 10-K Report at Part II, Item 6 (showing maintenance costs of $6.7 million and selling, general and administrative costs of $17.7 million). *See* Exhibit 2.

maintenance costs is used to represent an allocation for administration, general and sales expenses in the cost calculation below. It should also be noted that the Coalition has represented overhead expenses to be just slightly less than 2.5 times maintenance expenses in their filings with the FCC.[37]

64. Another cost of providing long distance inmate calling service is the cost incurred in the transmission and termination of the calls, *i.e.*, the cost of long distance transport to the called party's local calling area and the cost of terminating each long distance minute at the final destination. In the competitive scheme described here, this cost would be borne by the competitive interconnecting carriers, rather than the underlying inmate telephone system provider. For long distance transport, carriers typically use T-1s or larger circuits. In this case, such circuits would begin at each prison switch and reach to the nearest POP on the interconnecting carrier's toll network. Using the average of 70 telephones in each prison, as discussed above, a service provider would need approximately three T-1s for transport to its long distance network. Because a single T-1 has 24 voice channels available, three T-1s would allow for 72 simultaneous calls. Based on my recent experience, an average T-1 circuit costs around $400 per month. T-1 costs vary drastically across the U.S. by market, but $400 is a conservatively high estimate of the composite monthly cost of T-1s across the country. Accordingly, an annual transport cost of $14,400 is used in the cost calculation below.[38]

65. Evercom, like most inmate service providers and other IXCs, does not own a nationwide long distance network. It therefore has to pay a wholesale IXC to carry each long distance inmate call to the recipient's local calling area and to arrange for local terminating

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[37] *See* Coalition Cost Analysis (showing overhead -- $0.224 per call -- equal to 2.49 times maintenance -- $0.09 per call -- for an inmate local collect call), attached hereto as Exhibit 12.

[38] Four hundred dollars per month for an average T-1 circuit is a rate that would be available only to a carrier purchasing a fairly large volume of capacity. That rate multiplied by three circuits multiplied by 12 months equals $14,400.

access to the recipient. Such wholesale long distance contracts are routine for long distance resellers like Evercom, which typically use the underlying network of one or more large IXCs, such as AT&T, MCI (formerly known as WorldCom) or Sprint.[39] A carrier would have to pay no more than 2.5 cents per minute to get long distance calls terminated through one of these facilities-based IXCs. As far back as 1996, the Coalition estimated that its members' long distance transmission cost was approximately 2.5 cents per minute.[40] Since then, long distance wholesale costs have declined drastically, and wholesale long distance terminating rates, including terminating access charges paid to the terminating LEC, are now as low as 1.8 cents per minute for large volume users.[41] Accordingly, the 2.5 cents per minute rate will be used as a conservative estimate of long distance transmission plus termination in the cost calculation below, although these costs are certainly lower today.

66. Finally, it is necessary to estimate the volume of long distance usage from the average prison. Based on available data, a low and a high estimate of calling volume can be derived in order to develop a range of possible per-minute costs. This exercise also shows that costs decrease with increased calling volume. The low estimate assumes that each prisoner averages one hour of calling per week, and the high estimate assumes that each prisoner averages

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[39] It should be noted that, although resellers obtain facilities from other carriers, a reseller carrying an inmate call would nevertheless be fully capable of retaining complete control over the entire transmission of the call.

[40] *See* Comments of Inmate Calling Services Providers Coalition at 8 n.14, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128 (July 1, 1996) ("1996 Coalition Comments"), attached hereto as Exhibit 13. AmeriTel Pay Phones, Inc. and InVision Telecom, Inc., *see id.* at 1 n.1, were predecessors to Evercom. *See* 10-K Report at Part I, Item 1, "General," attached hereto as Exhibit 2.

[41] Of that 1.8 cents per minute, only .71 cents per minute was accounted for by local terminating access charges as of June 2003. *See* Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission, Trends in Telephone Service at Table 1.2 (August 2003). The relevant portions of the FCC's report are attached hereto as Exhibit 14.

1.5 hours of calling per week. The low estimate is derived from a report prepared by the California Department of Corrections concerning the BOP inmate telephone system, which estimated that BOP inmates average 242 minutes of calling per month (approximately one hour per week).[42] The higher estimate is derived from the BOP RFP discussed above, which indicates that the average federal prisoner makes 1.4 hours of long distance calls per week.[43]

67. There is one additional cost of prison calling that is not included in these cost figures. Many prison systems charge a commission to inmate service providers as a cost of doing business in the prison. As this Commission reiterated in the *Inmate Payphone NPRM*, location rents (*i.e.*, commissions) are not legitimate costs of providing service; rather, they are an element of profit.[44] Additionally, not all prisons systems charge commissions. For these reasons, commissions have been excluded from these cost calculations. Commissions have also been removed from the comparable costs figures cited from other FCC filings discussed throughout this affidavit. It should be noted that, although commissions are not a legitimate expense of inmate calling services, as a practical matter, they nevertheless inflate the rates charged by Evercom and other service providers. According to the Coalition Cost Analysis, commissions amount to 30 percent of the total cost of inmate calls, including all profit.[45] If that is true, commissions add another 43 percent (*i.e.*, 30% / 70%), to total costs before commissions, which must be presumed to exert a commensurate upward pressure on calling rates.

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[42] CDC Report, Executive Summary at 1 (attached to Virginia Inmate Report) (attached hereto as Exhibit 8).

[43] Exhibit J-2 of the BOP RFP shows an average of 4,991 minutes per year of telephone usage per inmate, of which 749 minutes are local calls, for an average of 4,242 long distance minutes per year, which is slightly under 1.4 hours per week of long distance calling. Exhibit J-2 is attached hereto as Exhibit 15.

[44] Order on Remand & Notice of Proposed Rulemaking, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 17 FCC Rcd 3248, 3255 & n.49 (2002) ("*Inmate Payphone NPRM*").

[45] *See* Coalition Cost Analysis, attached hereto as Exhibit 12.

68. Following is a calculation of the total cost per minute of running a prison calling system using all of the assumptions and inputs discussed above. Because costs vary by call volume, one can easily postulate that costs also vary by prison size, with larger prisons having lower per minute costs. As noted above, the three sample CCA prisons currently or previously served by Evercom have an average population of 1,743 prisoners. The cost calculation is set forth in two columns, with the first column showing low prisoner calling at one hour per prisoner per week and the second column showing 1.5 hours of calling per prisoner per week. Each entry will first be calculated on an annualized basis, rounded off to the nearest thousands of dollars, and then divided by the low and high call volume estimates in order to derive low and high per-minute costs.[46]

Estimate of Evercom Costs	Low Estimate	High Estimate
Average Number of Prisoners	1,743	1,743
Average Calling Per Prisoner Per Week	1.0 hr	1.5 hr
Calling Hours Per Week	1,743	2,615
Annual Minutes	5,438K	8,157K
Operating Costs		
Wholesale Long Distance and Termination[47]	$ 136K	$ 204K
Transport	$ 14K	$ 14K
Total Long Distance Costs	$ 150K	$ 218K

[46] Because of the unavoidable inefficiencies of serving extremely small facilities, this analysis may not apply to locally-administered jails and other low-capacity prison facilities.

[47] The estimated wholesale cost of long distance transmission and termination of 2.5 cents per minute was multiplied by the low and high annual estimated minutes to derive low and high annualized totals.

Depreciation[48]	$ 69K	$ 69K
Maintenance[49]	$ 50K	$ 50K
Billing[50]	$ 111K	$ 167K
Uncollectibles[51]	$ 334K	$ 502K
Administration & Sales[52]	$ 130K	$ 130K
Total Expenses	$ 844K	$1,136K
Total Cost per Minute	$ 0.155	$ 0.139

69. This demonstrates that the total cost of providing long distance inmate calling service, before profit and taxes, is somewhere between 13.9 cents and 15.5 cents per minute. This is far below the revenues providers like Evercom collect for interstate calling, as discussed above.

70. From these total cost estimates, it is then possible to break out the cost of providing just the underlying inmate telephone system by eliminating the long distance and other

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[48] As described in paragraph 58, depreciation is based on an average useful life for all equipment of 5.5 years. The equipment costs are as follows:

Hardware	
Switch	$ 350K
Telephones	$ 28K
Total Hardware	$ 378K

($378,000/5.5 = $69,000).

[49] As described in paragraph 59, maintenance is estimated at 13.2 percent of the total equipment costs.

[50] Billing costs are estimated to be 2.5 percent of billed revenues per paragraph 60. These amounts were calculated by assuming that average billing is 82 cents per minute for the assumed minutes multiplied by 2.5 percent.

[51] As explained in paragraph 62, uncollectibles are calculated by taking 7.5 percent of total revenues, based on a composite revenue estimate of 82 cents per minute.

[52] As explained in paragraph 63, general, administration and sales expenses are estimated by multiplying maintenance expenses by 2.6.

costs that could be avoided by a firm acting solely as the provider of the underlying system. For example, the actual cost of providing the long distance transmission -- both the network costs per minute and the transport -- would become the responsibility of each competing interconnecting IXC. Also, under the system described here, because the underlying system provider would bill its per-minute charge to the competitive interconnected IXC terminating each call, the underlying system provider would have no billing or uncollectibles costs. Moreover, because most calls would become prepaid debit calls under a competitive system, the cost of billing and uncollectibles would largely disappear in any event.[53] Eliminating the avoided costs, the costs of providing the underlying inmate telephone system for long distance service is as follows:

	Low Estimate	High Estimate
Total Expenses (from above)	$ 844K	$1,136K
Less Avoided Costs		
Less Long Distance Costs	$ 150K	$ 218K
Less Billing	$ 111K	$ 167K
Less Uncollectibles	$ 334K	$ 502K
Total Underlying System Costs	$ 249K	$ 249K
Underlying System Cost per Minute	$ 0.046	$ 0.031

This demonstrates a range of costs for the underlying system provider of 3.1 cents to 4.6 cents per minute. Note that the cost per minute decreases with a greater calling volume.

71. There are two possible categories of costs to add to these figures. First, it is reasonable to allow the underlying system provider to make a profit. In the wholesale long distance business, a reasonable profit for most carriers, after all costs, is roughly one cent per

[53] It should be noted that in the BOP inmate telephone system, 92 percent of the long distance calls are prepaid debit calls, and the rest are collect. Virginia Inmate Report at 14, attached hereto as Exhibit 8.

minute. This estimate of profit compares well with the profit estimated by the Coalition[54] and thus is a reasonable profit component. Along with profit comes the need to recognize the cost of income taxes. Evercom is a relatively young company and, as such, it has yet to pay any significant income taxes.[55] For other providers, however, and, eventually, for Evercom, there would be income taxes to be recovered. While taxes for most providers are theoretically as much as 40 percent (when using the maximum possible tax rate), most telecommunications carriers pay less than a full tax rate because of various tax loopholes and write-offs. A tax level of 25 percent is typical for the industry over the long run. Accordingly, assuming profit of one cent per minute, income taxes might eventually be around $0.0025 per minute, or $0.003 per minute, rounded off to the nearest tenth of a cent. Adding $0.013 per minute for income taxes and profit, the reasonable rate for providing the underlying inmate telephone system is calculated to be between $0.044 and $0.059 per minute.

72. These calculated costs are comparable to the costs of providing inmate calling services as reflected in the Coalition Cost Analysis, which is attached hereto as Exhibit 12. That analysis shows a total cost, less commissions, of $1.508 for a 12-minute local call, or $0.126 per minute.[56] The basic costs for providing local inmate collect calls are very similar to the costs of providing long distance inmate collect calls. The difference between the two categories, from a cost perspective, is the difference between the cost of transport and termination of the long distance call and the local service charge for carrying the local call to the public telephone

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[54] *See* Coalition Cost Analysis (showing profit of 8.2 cents on a 12 minute local inmate collect call), attached hereto as Exhibit 12.

[55] *See, e.g.*, 10-K Report at Part II, Item 6 (income taxes for 2000 -- $553,000 -- slightly above one quarter of one percent of total operating expenses of $218,804,000), attached hereto as Exhibit 2.

[56] As explained above, commission payments to prisons are not a legitimate expense. The commissions cost of $0.647 for a 12 minute local inmate call has therefore been removed from the Coalition's total cost estimate of $2.155 in the Coalition Cost Analysis, attached hereto as Exhibit 12.

network. In the Coalition Cost Analysis, the Coalition indicates that the LEC service charges for carrying a 12-minute local inmate collect call to the public telephone network are $0.243, or $0.020 per minute.[57] In order to use the Coalition's data in an apples-to-apples comparison with the long distance inmate service cost calculations presented in this affidavit, the cost of the long distance transmission and termination plus the cost of transport to the long distance carrier must be substituted for the Coalition's local service charges. In the long distance cost calculations presented above, the costs of long distance transport and termination equate to about $0.027 per minute.[58] Substituting that figure for the Coalition's local service charge in its cost analysis yields the following:

Adjusted Coalition Costs	12-Minute Call	1-Minute Call
Long Distance Costs (substituted for local costs)	$0.324	$0.027
Billing & Validation	$0.350	$0.029
Maintenance	$0.090	$0.008
Depreciation	$0.110	$0.009
Overheads	$0.224	$0.019
Profit	$0.082	$0.007
Uncollectibles	$0.410	$0.034
Total Cost	$1.590	$0.133

It should be noted that the Coalition's adjusted cost of $0.133 per minute is even less than the lower estimate of the cost of inmate calling presented above, or $0.139 per minute, which does not include profit or taxes. It must be assumed that, in light of the inmate calling service providers' interest in higher rates, the Coalition data does not understate the cost of providing

[57] Coalition Cost Analysis, attached hereto as Exhibit 12.

[58] Dividing the "low estimate" long distance costs of $150,000 by the low annual traffic estimate of 5,438,000 minutes yields a per-minute cost of $0.02758. Dividing the "high estimate" long distance costs of $218,000 by the high annual traffic estimate of 8,157,000 minutes yields a per-minute cost of $0.02672, for an overall estimate of slightly over $0.027 per minute.

inmate telephone service. Because the adjusted Coalition-based data results in a lower cost estimate than the low estimate calculated above from Evercom data, the cost of providing the underlying inmate telephone system is likely to be at the low end of the range of costs calculated above, if not even lower. Moreover, the cost analysis presented here allows the underlying provider a greater profit per minute than is claimed in the Coalition figures, further confirming that the cost estimates presented here might overstate, but certainly do not understate, the costs of inmate calling.

73. In order to compare the adjusted Coalition estimate to the estimated cost of providing the underlying inmate telephone system presented above, it is necessary to remove the avoided costs of long distance, billing and the uncollectibles to arrive at the cost of the underlying system, as follows:

	12-minute Call	Per Minute
Adjusted Coalition Total Costs	$1.590	$0.133
Less Avoided Costs		
Long Distance Costs	$0.324	$0.027
Billing & Validation	$0.350	$0.029
Uncollectibles	$0.410	$0.034
Underlying System Costs	$0.506	$0.043

The adjusted Coalition data demonstrates a cost of $0.506 for a 12-minute call, or $0.043 per minute. This is even lower than the low end of the estimates of the cost of providing the underlying system presented above, which range between $0.044 and $0.059 per minute, thereby confirming the conservative nature of the cost calculations presented here.

74. Finally, As explained previously, the estimates of the total cost of providing inmate long distance calling service presented above -- $0.139 to $0.155 per minute before profit and taxes -- are a composite of debit and collect calling costs. As also explained above, billing costs and uncollectibles virtually disappear in the case of debit account or debit card calling.

Because billing costs and uncollectibles account for such a large portion of the total cost of providing inmate long distance calling service, debit calling could be provided much more cheaply than collect calling. Removing billing and uncollectibles costs from the composite total cost estimates reduces them by over six cents per minute, which is a tremendous proportion of the total cost of providing inmate long distance debit and collect services. Thus, long distance inmate debit calling could be provided at much lower rates than long distance inmate collect calling service.

75. Taken together, the analysis presented here and the comparison with the Coalition's data demonstrate that there exists a reasonable range of rates at which an inmate telephone system provider could operate an inmate calling system, make a reasonable profit and still leave room for multiple interconnecting long distance carriers to compete for inmate long distance calling. The range of estimates reflects the economies of scale in providing prison inmate calling and the different possible methods of calculating costs. These estimates demonstrate that a competitive prison inmate calling system of the type described in this affidavit is technologically and economically feasible and would result in much more affordable calling for prisoners. Moreover, as explained in Part VI above, such a system would meet all legitimate security, anti-fraud and other penological goals.

DOUGLAS A. DAWSON

STATE OF Maryland
CITY OF Riverdale

Sworn to before me this 29th day of October, 2003.

Notary Public

SHERRI N. SPENCE
NOTARY PUBLIC STATE OF MARYLAND
My Commission Expires August 14, 2007